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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1961

No. 884

R. A. HOLMAN & CO., Inc.,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION, ET AL.

Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA.

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Dated: April 17, 1962.

INDEX

	Page
Opinions Below	1
Jurisdiction	2
Constitutional Provision, Statutes and Regulations Involved	2
Questions Presented	2
Statement of the Case	3
1. *Identity of the Parties*	3
2. *The Statutory Context*	4
3. *The Regulations Challenged in this Proceeding*	6
a. *The Provisions of Rule 252(e)(2)*	7
b. *The Operation of Rule 252(e)(2) to Disqualify Petitioner*	8
c. *The Injury to Petitioner*	10
d. *The Commission's Proceedings Against Petitioner*	11
The Proceedings Below	11
Reasons for Granting the Writ	13
A. Introductory	13
B. *The Decision Below Should Be Reviewed to Settle the Permissibility of Administrative Denials of Due Process Absent Express Congressional Authority*	15
C. *The Decision Below Should Be Reviewed Because the Court Departed from Conventional Principles of Interpretation and Sought to Find Congressional Approval of a Rule of the Securities and Exchange Commission in the Failure of Congress to Pass Legislation*	18
D. *The Decision of the Court Below that the Securities and Exchange Commission without the Presence of a Quorum may issue an Order which has the Effect of Destroying a Going Business Should Be Reviewed by This Court*	22

Page

E. *The Decision Below Should Be Reviewed to Determine Whether It is Arbitrary to Destroy a Going Business Because Ex Parte Charges Have Been Filed When Other Adequate and Less Drastic Remedies Exist* 23

Conclusion 27

Appendix 28

A. Judgment Below 28

B. Opinion Below 28

C. Constitutional Provisions, Statutes and Regulations Involved 37

D. Pearson "Temporary Suspension Order" of September 16, 1960 48

Citations

Cases:

Adams v. *Milwaukee*, 228 U.S. 572 (1913) 25

C.A.B. v. *Delta Airlines*, 367 U.S. 316 (1961) 15

Cooley v. *O'Connor*, 79 U.S. (12 Wall.) 391 (1871) 22

Fahey v. *Mallonee*, 332 U.S. 245 (1947) 21

Gimbel Bros. v. *F.T.C.*, 12 Pike & Fisher Ad.L. (2d) 104 (1962) 23

Girouard v. *United States*, 328 U.S. 61 (1946) 18

Greene v. *McElroy*, 360 U.S. 474 (1959) 15, 17

Halsey, Stuart & Co. v. *Public Service Commission*, 212 Wis. 184; 248 N.W. 458 (1933) 21

Kent v. *Dulles*, 356 U.S. 116 (1958) 17

NLRB v. *Express Publishing Co.*, 312 U.S. 426 (1941) 24

North American Cold Storage Co. v. *Chicago*, 211 U.S. 306 (1908) 25

Standard v. *Olsen*, 347 U.S. 768 (1954) 17

United States v. *Crosby*, F.2d (2nd Cir. 1962) 22

STATUTES:

	Page
Administrative Procedure Act, 10, 5 U.S.C. (1964)	11
Securities Act of 1933, 48 Stat. 79 (1933), as amended,	2
Section 3(b), 15 U.S.C. § 77c(b)	2, 5, 13, 14
Section 8(b), 15 U.S.C. § 77h(b)	2, 19
Section 8(d), 15 U.S.C. § 77h(d)	2, 5
Section 12(2), 15 U.S.C. § 77l(2)	6
Section 17, 15 U.S.C. § 77q	6
Section 20, 15 U.S.C. § 77t	5
Section 20(b), 15 U.S.C. § 77t(b)	2, 19
Section 27	4
Securities Exchange Act of 1934, 48 Stat. 881 (1934), as amended,	2, 3
Section 4, 15 U.S.C. § 78e	4
Section 10(b), 15 U.S.C. § 78o(b)	2, 3, 5, 20
Section 19(a)(4), 15 U.S.C. § 78s(a)(4)	21
Section 24(c), 15 U.S.C. § 78u(c)	2, 6
Section 21(f), 15 U.S.C. § 77u(f)	2
District of Columbia Code § 11-305 (1961)	11
District of Columbia Code § 11-306 (1961)	11
28 U.S.C. § 1254(1)	2
28 U.S.C. § 1291	2
28 U.S.C. § 1292	2
28 U.S.C. § 1294	2
28 U.S.C. § 1331(a)	11
28 U.S.C. § 1346(a)(2)	11
28 U.S.C. § 2201	11
28 U.S.C. § 2202	11

REGULATIONS:

Securities Act Release 3466, § 217(b) (1953), 18 Fed. Reg. 1434-1435 (1953)	19
Securities Act Release No. 3663 (July 23, 1956), 21 Fed. Reg. 5739-5740 (1956)	2, 20
Rule 252(e), 17 C.F.R. § 230.252(e) (1962),	2, 7, 8, 9, 10, 11, 12, 13, 19, 23, 25
Rule 261, 17 C.F.R. § 230.261 (1962)	6, 7, 8, 9, 10, 11

Miscellaneous:

	Page
DOUGLAS, *Democracy and Finance*	16
Friendly, *The Federal Administrative Agencies: The Need for Better Definitions of Standards*, 75 HARV. L. REV. 863, 868 (1962)	22
GELLHORN, *Administrative Law Cases and Comments* (1960)	16, 17
LANDIS, JAMES L.: *Report on Regulatory Agencies to the President Elect* (1961)	22
Hearings Before the Committee on Interstate and Foreign Commerce, H. Rep., 83rd Cong., 2nd Sess. on H. R. 7550 and S. 2846, March 19, 1954	20
HOUSE REPT. 1542, 83rd Cong. 2nd Sess., *U.S. Code Cong. & Admin. News*, 2973 (1954)	20
SENATE REPORT No. 1036, 83rd Cong., 2nd Sess. (1954)	6
Securities and Exchange Commission, 23rd Annual Report (1958)	4
Securities and Exchange Commission, 24th Annual Report (1959)	5, 6
Securities and Exchange Commission, 27th Annual Report (1962)	13

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA.

Petitioner prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the District of Columbia Circuit, entered in the above-entitled case on January 18, 1962.

Opinions Below

On July 6, 1961 the District Court for the District of Columbia entered an Order dismissing the complaint for failure to state a cause of action and denying plaintiff's motion for preliminary injunction. JA 53. No written opinion was handed down. The Opinion of the United States Court of Appeals for the District of Columbia Circuit affirming the District Court is printed in Appendix B hereto, *infra*, page 28 and is reported at 299 F.2d 127.

Jurisdiction

The Court of Appeals for the District of Columbia Circuit had jurisdiction under 28 U.S.C. §§ 1291, 1292, 1294. Its judgment was entered on January 18, 1962, Appendix A, *infra*, page 28. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) (1958).

Constitutional Provision, Statutes and Regulations Involved

The Constitutional provision involved is the Due Process clause of the Fifth Amendment to the Constitution of the United States.

The statutory provisions involved are Sections 3(b), 8(b), 8(d) and 20(b) of the Securities Act of 1933, as amended, 15 U.S.C. §§ 77c(b), 77h(b), 77h(d), and 77t(b), (1958) and Sections 15(b), 21(e) and (f) of the Securities Exchange Act of 1934, as amended, 15 U.S.C. §§ 78o(b), 78u(e) and 77u(f), (1958).

The Regulation involved is Rule 252(e) promulgated by the Securities and Exchange Commission on July 23, 1956 in Securities Act Release No. 3663, 21 FED. REG. 5739-5740 (1956); 17 C.F.R. § 230.252(e) (1962).

They are printed in Appendix C, *infra*, page 37.

Questions Presented

1. May the Securities and Exchange Commission adopt a rule giving itself power summarily to deprive a registered securities broker of a going business *ex parte* and without notice and hearing, in the absence of any clear and specific delegation of such power by the Congress and in the face of statutory provisions to the effect that all powers delegated to the Commision including specifically the power to revoke or even temporarily suspend the license of a

broker may be exercised only "after notice and opportunity for hearing"?

2. As a matter of statutory construction, is it permissible for a court to consider the failure of Congress to pass legislation as a basis for implying power in an administrative agency to destroy a going business without notice or hearing?

3. May the Securities and Exchange Commission in the absence of a quorum issue an order which destroys a going business?

4. May the Securities and Exchange Commission promulgate a rule which has the effect of destroying a going business by virtue of the pendency of *ex parte* charges when there is no showing of a present violation of the securities laws, and if there were, any such violation could be prevented pending a hearing without destroying the going business?

Statement of the Case

(1) *Identity of the Parties:* Petitioner (plaintiff and appellant below) is a underwriter of securities duly registered as a broker-dealer pursuant to Section 15(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78o(b). It has specialized in underwriting the security issues of smaller companies, particularly the securities of small boat companies. It has been awarded a citation for "pioneering in the field of public financing and investment in the pleasure boat industry." (JA 2, 9-10).

Prior to the action of respondent, as hereinafter noted, the major portion of petitioner's business involved the underwriting of issues of securities filed by these smaller concerns pursuant to section 3(b) of the Securities Act of 1933 and Regulation A thereunder of the Securities and Exchange Commission governing offerings of $300,000 or less. Petitioner employed 25 persons and had engaged in 13

Regulation A underwritings. This record made it one of the two most active Regulation A underwriters in the United States.[1] Under Regulation A, public offerings of securities in the amount of $300,000, or less, are subject to a simplified scheme of registration with the Commission under the Securities Act, commonly known as the short form registration. It is intended to eliminate certain expenses of compliance applicable under the statute for large issues, the so called long form registration. The regulation accordingly provides the only practical way by which many small companies can issue securities to the public although they remain free as a theoretical matter to use the long form.[2] There is a substantial business for banking houses, like that of petitioner, in underwriting such Regulation A issues. (JA 2, 11).

Respondent, Securities and Exchange Commission, is a governmental agency created and deriving its powers under Section 4 of the Securities Exchange Act of 1934, and Section 27 of the Securities Act of 1933. The individual respondents comprise the members of the Securities and Exchange Commission.

(2) *The Statutory Context:* The statutes involved in this proceeding are the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, both of which are administered by the Securities and Exchange Commission. The Securities Act of 1933 was designed to provide disclosure to investors of material facts concerning securities publicly offered. The disclosure is obtained by requiring the issuer of the securities to file with the Commission a registration statement and related prospectus containing significant information about the issuer and the

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[1] This statement is derived from an analysis of the Investment Dealers' Digest Corporate Financing Directory, for the periods 1958 through 1960.

[2] Cf. 23 SEC Ann. Rep. 27 (1958).

offering. "The Commission has no authority to control the nature or quality of a security to be offered for public sale or to pass upon its merits or the terms of its distribution." 24 SEC ANN. REP. 28 (1959)

Under Section 8(d) of the Securities Act, the Commission is authorized after notice by personal service "and after opportunity for hearing" to "issue a stop order suspending the effectiveness of [a] registration statement." Under Section 20 "whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute . . . a violation of the [act]" it may bring an action in any federal court to enjoin such acts or practices "and upon a proper showing a permanent or temporary injunction or restraining order" shall be granted.

"The Securities Exchange Act of 1934 provides for the registration and regulation of Securities Exchanges, and the registration of securities listed on such exchanges, and it establishes, for issuers of securities so registered, financial and other reporting requirements, regulation of proxy solicitations and requirements with respect to trading by directors, officers and principal stockholders. The Act also provides for the registration and regulation of brokers and dealers doing business in the over-the-counter market, [and] contains provisions designed to prevent fraudulent, deceptive and manipulative acts and practices on the exchanges and in the over-the-counter markets . . ." 24 SEC ANN. REP. 56 (1959)

Petitioner R. A. Holman & Co., Inc. is a registered broker-dealer under the 1934 Act. Under Section 15(b) of the Securities Exchange Act the Commission is authorized "after appropriate notice and opportunity for hearing . . . [to] revoke the registration of any broker or dealer" if it finds that such denial or revocation is in the public

interest"... and that the broker-dealer is guilty of certain specified violations. The Section also specifically provides that "pending final determination whether any such registration shall be revoked, the Commission shall by order suspend such registration if, *after appropriate notice and opportunity for hearing*, such suspension shall appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors."

Under Section 21(e) of the Act the Commission is authorized when it appears to it that any person is engaged or about to engage in any act or practice in violation of the Exchange Act to seek a permanent or temporary injunction against him in any Federal court.

(3) *The Regulations Challenged in this Proceeding.* Under Section 3(b) of the Securities Act of 1933 the Commission is authorized by rule and regulation to exempt issues of $300,000 or less from the registration provisions of the 1933 Act. The purpose was to "facilitate public financing by small business". S. Rept. No. 1036, 83rd Cong., 2nd Sess. (1954). In the words of the *24th Annual Report* of the Securities and Exchange Commission "exemption from registration under Section 3(b) of the Act does not carry exemption from the civil liabilities for false and misleading statements imposed upon any person by section 12(2) or from the criminal liabilities for fraud imposed on any person by section 17 of the Act." (p. 42). Pursuant to this exemption in Section 3(b), the Securities and Exchange Commission promulgated Regulation A governing offerings of $300,000 or less. The Regulation provides for the filing of information with the Commission and the use of an offering circular which is very similar to the prospectus required under a full registration statement. Under Rule 261 of Regulation A the Commission gives itself the summary power to suspend *ex parte* a Regulation A exemp-

tion pending a hearing to determine whether or not the suspension shall be made permanent. Under Rule 261 the underwriter is not even entitled to notice of the entry of the order. Since July 23, 1956, under Rule 252(e)(2), one of the consequences of an *ex parte* suspension order is to preclude the underwriter from engaging in any Regulation A offerings. It is the application of the automatic disqualification, as provided by this Rule, which is challenged in this proceeding.

(a) *The Provisions of Rule 252(e)(2).* Rule 252(e)(2) was included in Regulation A on July 23, 1956. It provides that whenever the Commission, pursuant to Rule 261,[3] issues an *ex parte* order suspending an offering of securities under Regulation A, the underwriter, *ipso facto*, is precluded from engaging in selling not only the suspended issue suspected of being defective but all other issues filed by another company under Regulation A no matter how free from question they may be. The disqualification is automatic, solely on the basis of pending charges, without a hearing, notice, or findings. Regulation A, as amended on July 23, 1956 provides:

> "(e) No exemption under this regulation shall be available for the securities of any issuer if any underwriter of such securities, or any director, officer or partner of any such underwriter was, or was named as, an underwriter of any securities

[3] As stated above Rule 261 of Regulation A provides that if the Commission believes that any filing under the Regulation does not comply with the Regulation, it may, without notice and hearing to anyone, enter an *ex parte* order suspending the effectiveness of the filing. A hearing may be requested, but even though requested, the suspension order remains in effect.

> "(2) covered by any filing which is subject to pending proceedings under Rule 261 or any similar rule adopted under Section 3(b) of the Act, or to an order entered thereunder within five years prior to the filing of such notification."

This disqualification remains in effect pending, and until completion of, any proceedings under Rule 261 with respect to the suspension order. Rule 261(b).

(b) *The Operation of Rule 252(c)(2) to Disqualify Petitioner:* In March, 1959, Pearson Corporation, a manufacturer of small boats in Rhode Island, filed under Regulation A a Notification and Offering Circular to sell 175,000 shares of its common stock at $1.00 per share. Petitioner was the underwriter for the offering. The filing became effective in late April, 1959, and was completely sold to over 200 persons and 21 broker-dealers at $1.00 per share.

Among the original purchasers at the public offering price of $1.00 were officials of the underwriter and members of their families who were regular customers of the firm. Without exception every purchaser at the public offering price who sold his stock received a profit—for the stock at all times traded at a price in excess of $1.00 per share, the offering price.

Prior to the underwriting Pearson Corporation had only $202.00 in cash and a negligible operating history. For the year after the public offering Pearson Corporation's sales volume, aided by the capital from the underwriting, had increased to approximately $2,000,000 and the company then employed approximately 200 people.

More recently, the highly successful Pearson Corporation merged with Grumman Boat Company and as a result Grumman Aircraft Engineering Corporation is now the major stockholder of Pearson Corporation.

Following the completion of the Regulation A offering in April, Pearson Corporation common stock was quoted in active trading in the over-the-counter market at $2.00. In September, 1960, its stock was selling at $8.00 a share. Since April, 1960, it has never traded below $4.00. (JA 3, 12-13).

On September 16, 1960, *sixteen months after the issue had been completed*, without notice and hearing granted to petitioner or Pearson Corporation, the Commission, at a time when, according to an uncontradicted affidavit filed herein, no quorum was present, on the basis of allegedly erroneous information given to it by its staff *ex parte*, issued an order under Rule 261 "temporarily" suspending the Regulation A exemption of the Pearson issue. The order claimed that the distribution of the issue involved violations of the Securities Act. It offered the company an opportunity for a hearing which the company duly demanded. For the text of the Pearson Order see Appendix D, *infra*, page 48. This hearing, in which petitioner is participating, is now in progress before a Hearing Examiner of the Commission. The Commission staff's direct case which started in January, 1961 was closed on March 5, 1962 at which time the record comprised approximately 5900 pages; most of which did not relate to the Regulation A Suspension Order.

The Commission's order purporting to suspend the 1959 filing of Pearson Corporation, of course, had no effect whatsoever on that offering since it had been completely sold. It did not prevent plaintiff from continuing to trade in the securities of Pearson Corporation, nor did it affect anybody else's right to buy and sell those securities, the issue having long been sold to the satisfaction of the company, the underwriter, and the members of the public who purchased the securities. Its only effect was to bring into play Rule 252(e)(2) and to disqualify petitioner from engaging as underwriter of *any* securities under Regulation A.

(c) *The Injury to Petitioner:* Petitioner, on September 16, 1960, was actively engaged in underwriting securities of other companies which had been qualified under Regulation A. After the order was issued, and as a result of the disqualifying effect of Rule 252(e)(2), petitioner was required to immediately suspend these sales which occasioned it substantial losses. It was also required to abandon negotiations to underwrite a number of issues for which filings under Regulation A were contemplated. (JA 6, 15).

The Commission communicated immediately with several of petitioner's customers instructing them to discharge petitioner as underwriter if they wished to proceed with their Regulation A offerings. Thus, in a telegram of September 20, 1960 to the Aluminum Insulating Co., Inc., the Commission advised that they should discontinue their offering pending appointment of a new underwriter. (JA 5-6, 15). By letter of September 17, 1960 the Commission notified another of petitioner's customers, Polytronics Laboratories, Inc., that the petitioner's "disability renders the [Regulation A] exemption unavailable . . .". (JA 6, 15).

As a result of operation of Rule 252(e)(2) and the Commission's actions thereunder, petitioner's underwriting business was practically destroyed and its staff was substantially reduced. (JA 6, 15). The Court of Appeals characterized the injury as extensive and perhaps irremediable. App. B, *infra*, p. 32. The disqualification of petitioner under Rule 252(e)(2) will be removed only in the event that the Commission, upon completion of the proceedings under Rule 261, decides on the merits to revoke the suspension order or to cancel it *nunc pro tunc* on the ground that it was not validly issued since a quorum was not present. But such a decision, of course, would afford petitioner no relief from the disqualification which it is now suffering prior to the completion of the hearings. It is this

disqualification, pending the conclusion of the hearing, of which petitioner complains.

(d) *The Commission's Proceedings Against Petitioner:* As noted, the Commission's order of September 16, 1960, temporarily suspending the Regulation A exemption, was set down for hearing, under Rule 261, to determine whether or not it should be made permanent. *In the Matter of Pearson Corporation*, File 24B-1677. On the basis of the same charges against petitioner, the Commission, by order of September 26, 1960, initiated hearings under Section 15(b) of the Securities Exchange Act of 1934 to revoke petitioner's broker-dealer registration. *In the Matter of R. A. Holman & Co., Inc.*, File 8-6858. These proceedings were later consolidated by the Commission. Subsequently, a further consolidation was made of a proceeding against another broker-dealer. The issues in this latter proceeding bear no relationship to the issues in the proceeding pursuant to the September 16 Order. Yet, the bar which the court below termed "temporary" continues pending a decision on this multiphase consolidated proceeding. It is only the effect of the Order of September 16, 1960 and Rule 252(e)(2) which is here challenged because of all the welter of material, only this *ex parte* order, under the Commission Rule, has the impact to destroy petitioner's Regulation A underwriting business.

The Proceedings Below

Petitioner initiated an action in the District Court for the District of Columbia. On June 15, 1961, it filed a complaint and on June 15, 1961, it moved for a preliminary injunction against the operation of Rule 252(e)(2).[4] Peti-

[4] The District Court for the District of Columbia had jurisdiction under D.C. Code §§ 11-305, 306 (1961), 28 U.S.C. §§ 1331(a), 1346(a)(2), 2201, 2202 (1958), and Section 10 of the Administrative Procedure Act, 5 U.S.C. § 1009 (1958).

tioner also moved for a motion to stay the Commission's proceedings until the Court disposed of the case. The Commission moved to dismiss the complaint. On July 6, 1961, the District Court granted the Commission's motion and denied petitioner's request for injunctive relief. No opinion was issued by the District Court.

On appeal, the Court of Appeals for the District of Columbia Circuit by opinion of January 18, 1962 sustained the District Court. To the extent here relevant, the Court of Appeals held that R. A. Holman & Co., Inc., was "extensively and perhaps irremediably damaged" by the operation of Rule 252(e)(2) and that the District Court had jurisdiction to decide the constitutional and statutory issues before it.* The Court concluded that the Rule in question constituted permissable balancing between the public interest in protecting investors and the private interest of a broker-dealer in continuing his business. The Court found Congressional sanction for this balancing not in the express terms of the acts administered by the Commission but on the assumption (incorrect, as will be shown below) that in 1954 when Congress declined to pass legislation increasing the amount of the permissible Regulation A exemption, at the request of the Securities and Exchange Commission, it was aware of the disqualification provisions of Rule 252(e)(2) (first promulgated in 1956) and in effect approved this particular exercise of the Commission's rule making authority.

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* The Court stated "But if Rule 252(e)(2) is invalid, Holman's business will have been extensively and perhaps irremediably damaged long prior to the review of the final order. . . . The House Report on a bill offered in 1954 to amend certain provisions of the securities legislation noted that Regulation A in its present form "provides for disclosure and disciplinary checks and suspension power so as to assure that issues offered under the regulation are offered under conditions which furnish practical protection against fraud." The corresponding Senate Report also indicated that the Commission's regulations were known to the Congress and formed parts

Reasons for Granting the Writ

A. *Introductory*

The decision of the court below involves the construction of the Federal securities laws and the rule making powers of an administrative agency in light of constitutional due process requirements of notice and hearing. The holding that a business, absent express statutory authorization, may be destroyed by the Securities and Exchange Commission, under the authority of one of its own rules, summarily, and without notice or hearing, is of profound importance to and adversely affects the approximately 5,500 stock brokers registered with the Securities and Exchange Commission[5] who have in the past or who may in the future participate in Regulation A offerings. During the 1961 fiscal year there were 1,057 filings under Regulation A covering offerings of over 239 million dollars of securities.[6] The business of many broker-dealers, such as R. A. Holman & Co., Inc., consists substantially of providing public financing, generally for small companies, pursuant to Regulation A. Equity financing for small business is important to the economic well-being of the Nation and the maintenance of the free enterprise system. Regulation A offerings are the only practical method of financing many small businesses as both Congress and the Securities and Exchange Commission have recognized on numerous occasions.

The court below held that by virtue of the Securities and Exchange Commission's authority under Section 3(b)

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of the basis upon which the new proposals should be considered. We must conclude that Congress saw nothing in Regulation A as a whole, or in Rule 252 in particular, which conflicted with its purpose; the contrary inference is rather to be drawn." Appendix B, *infra*, pp. 32, 36, 37.

[5] 27 SEC. ANN. REP. 1 (1962).

[6] *Id.* at 41.

of the Securities Act of 1933 to exempt from registration issues of securities of $300,000 or less and its rule making power it could provide as it did in July 1956 in Rule 252(c)(2) that a broker-dealer may be singled out and deprived, without notice or hearing, of his right to do business under the exemption, even if that is his primary business. This holding of the court below has the most serious implications not only to registered broker-dealers in the securities field but to small companies who may be deprived of opportunities to secure equity financing. Section 3(b) was adopted to facilitate public financing by small businesses. The continued existence of summary power to destroy an underwriting business, as exemplified by this case, can only deter broker-dealers from assisting in financing pursuant to Section 3(b).

The holding is equally important to businessmen generally who are subject to administrative regulation, whether by the SEC or other agencies. The decision purported to be based not on express Congressional authorization but on the limited power of the Agency to adopt rules for "exemptions" from the general regulatory pattern and the "intent of Congress" incorrectly derived from its failure to pass legislation. This conclusion was reached in the face of specific provisions of the Securities Exchange Act which provides that the license of a broker-dealer may be revoked only upon notice or hearing and the provisions of the Securities Act of 1933 which require notice and opportunity for a hearing whenever the Commission seeks to prevent the sale of particular securities.

If the decision below is allowed to stand, any administrative agency authorized to make exemptions will be also entitled to withdraw the right to do business under the exemption without notice or hearing even if so doing in-

volves destroying a going business. The decision below is such that agencies will have this power even when their general grant of authority, like that of the SEC, specifies that they may act only in accordance with the traditional procedural safeguards founded on the Constitutional requirements of notice and hearing prior to the imposition of a sanction.

B. *The Decision Below Should Be Reviewed to Settle the Permissability of Administrative Denials of Due Process Absent Express Congressional Authorization.*

The opinion below should be reviewed because it raises important questions relating to the permissability of administrative denials of procedural due process in the absence of express Congressional authorization. The principal constitutional implication of the decision below is that it provides an avenue for escape from the repeated pronouncements of this Court to the effect that the right to follow a chosen profession "free from unreasonable governmental interference" comes within the liberty and property concepts of the Fifth Amendment and that only by the most explicit Congressional action may the traditional forms of fair procedure be curtailed. *Greene* v. *McElroy*, 360 U.S. 474 (1959). See also *C.A.B.* v. *Delta Airlines*, 367 U.S. 316 (1961).[7] As this Court stated in *Greene* v. *McElroy*, *supra*, at 507-508:

> "Where administrative action has raised serious constitutional problems, the Court has assumed that Congress or the President intended to afford those

[7] In the *Delta* case this Court pointed out that even the alteration of a carrier's certificate might be construed to require notice and hearing to the carrier prior to agency action stating: "We do not think it too much to ask that the Board furnish these minimum protections as a matter

affected by the action the traditional safeguards of due process . . . These cases reflect the Court's concern that traditional forms of fair procedure not be restricted by implication or without the most explicit action by the Nation's lawmakers, even in areas where it is possible that the Constitution presents no inhibition."

What the court below has done is to balance what it conceives to be the competing interests involved as if the Rule promulgated by the Securities and Exchange Commission were a statute to be tested against the Constitution as representing the considered judgment of Congress. Of course, an administrative regulation is nothing of the kind. "The administrative agency has no powers but the powers granted in the statute. Its rule making power is prescribed by the law itself."[8]

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of course, whether or not the Board in a given case might think them meaningless. It might be added that some authorities have felt strongly enough about the practical significance of these protections to suggest that their presence may be required by the Fifth Amendment. . . ." 367 U.S. at 331-332.

[8] DOUGLAS, DEMOCRACY AND FINANCE, 245.

The following discussion of the factors to be considered by Congress when deciding whether or not to invest an administrative agency with summary powers appears in GELLHORN, ADMINISTRATIVE LAW CASES AND COMMENTS 774 (1960):

"Yet, to argue that the legislature may constitutionally grant power to make provisional determinations summarily, is not to argue that the legislature should freely do so. Such a power involves obvious and grave dangers. Its misuse might destroy as fully as its proper use might protect. Before it is conferred, therefore, the legislature should in each particular case cautiously evaluate the need for so potent a weapon. Moreover, provisional orders pending the outcome of formal hearings should be allowed to have only a limited life span, lest delay in bringing cases on for hearing convert temporary decisions in effect into final ones. Further, the need for truly summary entry of provisional orders is infrequent. Rarely will a case arise in which time

When serious constitutional problems are raised by administrative action that action can be sustained only on the basis of clear and specific delegations of power to the agency by Congress. If the delegation has not been made to the agency the Rule is in excess of its authority. If it is not clear whether the power has been granted by Congress, it will not be readily inferred. *Kent* v. *Dulles*, 356 U.S. 116, 129 (1958). On the contrary, it will be assumed that Congress did not authorize the agency to impinge on Constitutional rights. *Greene* v. *McElroy*, *supra* at 507. Heretofore, it was assumed that only when Congress had spoken clearly would the constitutional issue be presented. But the court below anticipated the constitutional issue by considering and sustaining the Commission's imposition of a serious sanction on a broker-dealer, namely depriving him of a going business, in the face of Congressionally imposed requirements that the Commission act only with notice and hearing, or through court proceedings where both parties may be heard.

If this decision is allowed to stand, the administrative agencies generally, whose actions to a large measure are reviewed by the Court of Appeals for the District of Colum-

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cannot be allowed for a hearing on the question whether good cause exists for making an order in advance of the hearing on the merits."

Professor Gellhorn's reference emphasizes the fact of legislative discretion and is particularly significant in view of a Senate Committee report in which the following statement appears with respect to summary proceedings.

> "* * * Such power is directly contrary to the letter and spirit of normal due process, as exemplified by the Administrative Procedure Act, which requires a hearing before any penalty may be imposed." Gellhorn, *id.* at 772.

As was stated in *Standard* v. *Olsen*, 347 U.S. 768, 771 (1954),

> "* * * it is for Congress, not the courts, to write the law. Under the law, as presently written, every business, until found unlawful, has the right to be let alone."

bia Circuit, will be limited not by powers specifically given to them by Congress but only by the powers which a Court determines that Congress, if it chose to do so, could give them under the Constitution. This departure from prior rules of constitutional interpretation should be reviewed by this Court.

C. *The Decision Below Should Be Reviewed Because the Court Departed from Conventional Principles of Interpretation and Sought to Find Congressional Approval of a Rule of the Securities and Exchange Commission in the Failure of Congress to Pass Legislation.*

The court below felt obligated to find implied Congressional approval of the rule of the Commission which deprives a broker-dealer of a going business without notice or hearing. It did this by ignoring the pattern of legislation passed by the Congress in the securities field and relied on what it assumed was known to Congress when it refused to enact certain technical amendments to the securities laws. In view of this Court's statement in *Girouard v. United States*, 328 U.S. 61, 69 (1946) that

> "* * * It is at best treacherous to find in Congressional silence alone the adoption of a controlling rule of law"

this reliance on supposed Congressional intent is completely misplaced. As a result of this reliance on a "treacherous" technique of interpretation, the court derived impermissible conclusions from the inaction of Congress. Indeed, if contrary to our view, recourse to legislative history of measures which Congress did not pass is at all

permissible, it would show the contrary of what the court below decided."

The court by using this rule of interpretation ignored clearly express Congressional intent reflected in the Securities Act of 1933 and the Securities Exchange Act of 1934. These statutes provide, subject only to very specific and limited exceptions, where private rights are affected there should be adequate "notice and opportunity for hearing." Nowhere does the Securities Act of 1933 provide for Commission action without hearing. Under Section 8(d) of the Securities Act, 15 U.S.C. § 77c(b), the Commission may issue a stop order precluding further sales of a registered security only after notice and opportunity for hearing. Under Section 20 of the Act, 15 U.S.C. § 77t(b), the Commission has the power to go immediately into Court and seek

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[9] The Court mistakenly attempted to find Congressional approval of Rule 252(c)(2) of Regulation A by retering to the 1954 House and Senate reports relating to the refusal by Congress at that time to follow the request of the Commission and to increase the Regulation A exemption from $300,000 to $500,000. The Court in its opinion stated that the Commission's regulations were "known to the Congress" and that it "must conclude that Congress saw nothing in Regulation A as a whole, or in Rule 252 in particular, which conflicted with its purpose: the contrary inference is rather to be drawn." Contrary to this assumption, at the time Congress decided not to increase the size of the Regulation A exemption, the regulations promulgated thereunder by the Securities and Exchange Commission did not exclude an underwriter from Regulation A offering merely because proceedings had been instituted *ex parte* against a particular offering with which he had been connected. The Rule provided that an underwriter would be debarred from Regulation A only if he had been (1) convicted of a crime involving securities; (2) was subject to a final order enjoining him from certain practices relating to securities or issues and (3) subject to a Post Office fraud order. Securities Act Rel. 3466, § 217(b)(5), 18 FED. REG. 1434-1435 (1953).

Further, the Chairman of the Commission in describing the procedures under Regulation A represented to Congress that the Commission could suspend the Regulation A exemption "by order, after hearing." In the written statement made to the House Committee on Interstate and Foreign Commerce on March 19, 1954 (while deliberating on H.R.

a permanent or temporary injunction or a restraining order to prevent imminent or existing violations of law in connection with the sale of securities. These Sections reflect the Congressional intention that the Commission operate by means of procedures where all parties have an opportunity to be heard.

Under Section 15(b) of the Exchange Act a broker-dealer registration may be revoked only upon notice and hearing. Congress, aware that under certain circumstances a broker-dealer should not be permitted to engage in business pending the outcome of a hearing, has specifically provided for the temporary suspension of a broker-dealer registration pending the outcome of a revocation hearing. However, Congress specifically provided that the temporary suspension may be ordered only after notice and opportunity for hearing though the hearing under the temporary suspension procedure need not be as comprehensive as a full revocation hearing.

The Exchange Act contains only two provisions providing

7550 and S. 2846), Ralph H. Demmler, then Chairman of the Commission, stated, *inter alia:*

> "In brief, Regulation A prescribes the conditions under which the exemption is available and requires the use of an offering circular containing prescribed minimum disclosures. The regulation further provides that the commission may suspend the exemption by order, after a hearing, upon the showing of a violation of the regulation."

Hearings before the House Committee on Interstate and Foreign Commerce on H. R. 7550 and S. 2846, 83rd Cong., 2nd Sess. at 42 (1954). The House and Senate reports on the rejected amendment contain the statement that the Regulation A exemption may be suspended "by order, after a hearing." See *H.R. Rep. 1542*, 83rd Cong. 2nd Sess., *U. S. Code Cong. & Ad. News*, 2973, 2990 (1954).

It was not until 1956, two years after the hearings relied upon by the court below, that the Commission amended Regulation A to provide that the issuance of an order *ex parte* suspending a Regulation A offering would have automatic collateral consequences beyond the particular issue of securities involved and completely preclude the broker-dealer from engaging in any Regulation A underwriting. This provision was adopted on July 23, 1956 in Securities Act Release 3663 (1956); 17 C.F.R. §§ 230.252 (1962).

for action without notice and hearing. Under Section 19(a)(4) the Commission may "summarily" suspend trading in a registered security on a national security exchange for a period not exceeding 10 days or with the approval of the President "summarily" suspend all trading on any national exchange for a period not exceeding 90 days. The exception to the general requirement of notice and hearing is clearly stated and carefully limited.[10] These statutory provisions, completely ignored by the Court below, reflect the clear and consistent intent of Congress, (and a balancing of interests by it) that the Commission, when proceeding both against particular issues of securities and against a broker-dealer, must do so with notice and opportunity for hearing prior to the imposition of a sanction. The finding of the Court of Appeals of a contrary intent of Congress from its inaction is of such consequence that it should be reviewed by this Court.

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[10] The court below put great reliance on the case of *Halsey, Stuart & Co. v. Public Service Commission*, 212 Wis. 184; 248 N.W. 458 (1933) which it cited *sua sponte* for the proposition that a stock broker's license may be suspended *ex parte*. The *Halsey, Stuart* case decided by a Wisconsin court in 1933 has not been relied upon since then by a Court outside Wisconsin. *Halsey, Stuart* turned upon the provisions of a State statute which specifically authorized *ex parte* suspensions and consequently has no bearing on the applicable Federal legislation which contains no such provisions. Furthermore, the issue was presented to the court in *Halsey, Stuart* after the broker had received a hearing on the suspension order. In *Fahey v. Mallonee*, 332 U.S. 245 (1947), also relied upon by the court, the statute authorized the Federal Home Loan Bank administrator to provide rules for the "reorganization, consolidation, merger, or liquidation of associations, including the power to appoint a conservator or a receiver. . . ." The administrator summarily appointed a conservator pursuant to his rules. The court upheld the rules because they contained "the usual and conventional grounds found in most state and federal banking statutes" and the court approved the exercise of summary power because it found that this was "an almost invariable custom" in the banking business. In addition, the appointment of a conservator has the effect not of destroying but of continuing a business, and did not act as a sanction.

D. *The Decision of the Court Below that the Securities and Exchange Commission without the Presence of a Quorum may issue an Order which has the Effect of Destroying a Going Business Should Be Reviewed by This Court.*

This Court should review the decision below for the purpose of determining whether the Securities and Exchange Commission, without the presence of a quorum, may issue an Order which has the effect of destroying a going business. Even if we assume, as did the court below, that the Commission absent specific Congressional authorization may destroy a going business without notice or hearing, and that Congressional approval may be found in Congressional silence, there is no basis upon which to assume that Congress departed from tradition and authorized the imposition of serious sanctions by Commission members individually and not by the Commission as a whole acting with a quorum present. *Cf. Cooley* v. *O'Connor*, 79 U.S. (12 Wall) 391 (1871). Particularly is this true in the present context where as James L. Landis stated in his *Report on Regulatory Agencies to the President Elect*, p. 47, with direct reference to the Securities and Exchange Commission "decisions, important decisions, are made by subordinates at fairly low levels. . . ."[11] Such decisions, even when formally rubber-stamped by the Commission, can destroy a going business. In the case before us, the then Chairman of the Commission acknowledged that the purported Order which had the consequence of destroying petitioner's business was issued without a quorum of

[11] Judge Friendly's comment in *United States* v. *Crosby*, —— F.2d —— (2nd Cir. 1962) "the statutory and administrative regulatory scheme in the present case. C. F. Friendly, *The Federal Administrative Agencies: The Need For Better Definition of Standards*, 75 Harv. L. Rev. 863, 868 [1952].

the Commission being present. JA 13. The court below held that the petitioner could not even challenge the legality of the suspension order itself until the conclusion of the administrative proceeding. The court thereby permitted petitioner's business to be destroyed by the issuance of an Order, which for the purposes of determining the sufficiency of the petition, did not represent official Commission action.

If administrative agencies are to be allowed by virtue of Congressional silence to exercise the tremendous powers permitted them by the court below, their actions should represent the considered decision of the Commission acting as such.[12] The decision of the court below that there is no relief from an illegally issued Order of the Commission has a great importance to the administration of the administrative agencies in general and should be reviewed by this Court.

E. *The Decision Below Should Be Reviewed to Determine Whether It is Arbitrary to Destroy a Going Business Because Ex Parte Charges Have Been Filed When Other Adequate and Less Drastic Remedies Exist.*

The Court of Appeals upheld the Commission's Rule 252(c)(2) which provides that the mere institution of charges *ex parte* precludes the broker from engaging in any Regulation A underwriting and thereby, as in this case, destroys a going business. There was no reasonable relation between the tremendous injury inflicted by the Commission and the evils sought to be prevented. Even were we to assume that a regulatory agency may on its own initia-

[12] *Cf.* the dissent of Commissioner Elman in *Gimbel Bros. v. F.T.C.*, 12 Pike & Fischer Ad.L. (2d) 104, 113 (1962), as follows: "Individual members of the Commission can not publicly announce the fact of, and reasons for, dissent when particular complaints are issued." If the decision below is allowed to stand, dissenting Commissioners will not even have to be consulted.

tive balance against the Constitution the competing interests involved, and bring proceedings in the absence of a quorum, there is no basis for the proceeding to encompass more than the prohibition of a particular issue of securities. It is not necessary to destroy a going business. The relationship between the penalty imposed and the violation charged should be considered by this Court. In the context of a National Labor Relations Board proceeding, *NLRB* v. *Express Publishing Co.*, 312 U.S. 426, 433 (1941), this Court stated:

> "* * * It would seem equally clear that the authority conferred on the Board to restrain the practice which it has found the employer to have committed is not an authority to restrain generally all other unlawful practices which it has neither found to have been pursued nor persuasively to be related to the proven unlawful conduct."

A similar examination of the sanction imposed by the Securities and Exchange Commission in this case is called for.

If, as the Commission has provided by its own rules, it can suspend a Regulation A offering *ex parte*, the public interest in precluding the sale of particular securities is amply protected without the necessity of destroying a going business. Furthermore, by statute the Commission is authorized to go into court and enjoin a particular offering made in violation of law.[13]

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[13] Indeed if there were public need and danger, the Act gave adequate attention to the public interest. The Commission may resort to courts of equity to enjoin threatened violations of law. In the present case it was a matter of public record in the Commission's files that the company in question and the underwriter intended in every respect to comply with the Commission's view of the law.

It is significant to note that if this case had involved serious violations of law, rather than at most technical and novel interpretations of unwritten

It is at most a procedure directed against a particular issue of securities which is sanctioned by the cases relied upon by the Court of Appeals. For example, *Adams* v. *Milwaukee*, 228 U.S. 572 (1913), (App. B, *supra*, p. 34), involved the constitutionality of an ordinance requiring milk producers shipping milk into Milwaukee to obtain a certificate that the cows from which the milk was taken were free from tuberculosis. The ordinance provided that milk shipped without a certificate could be seized. But the seizure of a shipment of milk would not put the farmer out of business, and at any time he could secure a certificate if his milk qualified.

The case of *North American Cold Storage Co.* v. *Chicago*, 211 U.S. 306 (1908), (App. B, *supra*, p. 34), involved issues similar to that presented in the *Adams* case, *supra*. The Court held that infected poultry could be seized without notice or hearing and that the owner could bring an action to recover the poultry or its value if it had been improperly seized. The governmental authorities prosecuting the action had taken the position they would not permit the cold storage company to conduct its business at all until the infected poultry was turned over. Though it became unnecessary to decide this issue, the Supreme Court said that closing down the business "would seem to have been

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policy retroactively applied, the Commission could have also instituted criminal proceedings, but even the institution of such proceedings would not by their mere institution alone (as in the case of a temporary suspension order under Rule 252(e)(2)) have destroyed petitioner's right to engage in Regulation A underwriting.

The theory advanced by the Commission is admittedly a new theory, and a member of its staff has so stated to the press. (JA 14). The purpose of the new policy of the Commission, adopted several months after the Pearson offering was made, required disclosure in Prospectuses and Offering Circulars that officers and employees of the underwriter were buying in a public offering at the public offering price. When this new policy was adopted, R. A. Holman & Co. became the first over-the-counter broker, to the knowledge of its President, to include in its filings the language required by the Commission. (JA 14).

arbitrary and wholly indefensible." 211 U.S. at 314. The action of the Securities and Exchange Commission in the case before us is similarly indefensible since the effect of its Order went beyond the suspension of the Pearson offering and precluded petitioner R. A. Holman & Co. Inc. from conducting his stock brokerage business which consisted of acting as underwriter of other Regulation A offerings for other companies as to which no charge of possible violation of law was involved.

Conclusion

The decision below should be reviewed to determine whether the Securities and Exchange Commission may adopt a rule giving itself power summarily to deprive a registered securities broker of a going business *ex parte*, and without notice and hearing, in the absence of a clear or specific delegation of such power to it by the Congress. Furthermore, *certiorari* should be granted to rule upon the question of whether Congressional intent may be determined from the failure of Congress to act, and whether the Securities and Exchange Commission may act in the absence of a quorum. In addition, this Court should consider whether a going business may be destroyed by the Securities and Exchange Commission when a less severe penalty amply protects the public interest.

Respectfully submitted,

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Dated: April 17, 1962.

APPENDIX

A. Judgment Below

Appeal from the United States District Court for the District of Columbia.

Before: Prettyman, Washington and Burger, Circuit Judges.

Judgment

This cause came on to be heard on the record on appeal from the United States District Court for the District of Columbia, and was argued by counsel.

On consideration whereof It is ordered and adjudged by this Court that the judgment of the District Court appealed from in this cause be, and it is hereby, affirmed.

Per Circuit Judge Washington.

Dated: Jan. 18, 1962.

B. Opinion Below

United States Court of Appeals for the District of Columbia Circuit

No. 16,464

R. A. Holman & Co., Inc., appellant,

v.

Securities and Exchange Commission, Et Al., appellees.

Appeal from the United States District Court for the District of Columbia

Decided January 18, 1962

Mr. Milton V. Freeman, with whom *Mr. Stuart J. Land* was on the brief, for appellant. *Mr. Edgar Brenner* also entered an appearance for appellant.

Mr. David Ferber, Assistant General Counsel, Securities and Exchange Commission, with whom *Mr. John A. Dudley*,

Attorney, Securities and Exchange Commission, was on the brief, for appellees.

Before PRETTYMAN, WASHINGTON and BURGER, Circuit Judges.

WASHINGTON, *Circuit Judge*: This litigation challenges the validity of action taken by the Securities and Exchange Commission against the appellant company, a registered broker-dealer in securities, which has specialized in underwriting securities pursuant to Regulation A of the Commission. Under Regulation A, speaking generally, public offerings of $300,000 or less are exempt from the principal registration requirements of the Federal securities legislation.[1] On the basis of material reported to it by its staff, the appellee Commission, on September 16, 1960, temporarily suspended the Regulation A exemption for the stock of Pearson Corporation, underwritten by appellant, and ordered hearings under its Rule 261[2] as to whether the suspension should be made permanent.[2] On September 26, 1960, the Commission instituted proceedings to determine whether grounds were present to revoke or suspend Hodman's registration as a broker and dealer in securities. The registration and the Regulation A suspension proceedings were combined on October 31, 1960.

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[1] Regulation A was promulgated pursuant to Section 3(b) of the Securities Act of 1933, 15 U.S.C. § 77c(b) (1958). It comprises Rules 251 through 262 of the Commission's Rules and Regulations under the Act.

[2] Rule 261 provides, in part:

"(a) The Commission may, at any time after the filing of a notification, enter an order temporarily suspending the exemption, if it has reason to believe that

"(1) no exemption is available under this regulation for the securities purported to be offered hereunder or any of the terms or conditions of this regulation have not been complied with, including failure to file any report as required by Rule 260.

"(2) the notification, the offering circular or any other sales literature contains any untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading . . . ."

and additional violations of the securities laws were alleged on November 15, 1960.[3] Hearings commenced on December 16, 1960, and have been continuing intermittently.

The Commission order of September 16, 1960, which temporarily suspended the Regulation A exemption, brought Rule 252(e)(2), which is included in Regulation A, into operation. This Rules provides:

> "(e) No exemption under this regulation shall be available for the securities of any issuer if any underwriter of such securities, or any director, officer or partner of any such underwriter was, or was named as, an underwriter of any securities—
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> . . . . . .
>
> "(2) covered by any filing which is subject to pending proceedings under Rule 261 or any similar rule adopted under section 3(b) of the Act, or to an order entered thereunder within five years prior to the filing of such notification."

The Rule thus automatically disqualified appellant from engaging in the distribution of securities under the privileges given by Regulation A. The disqualification will be removed if the Commission, upon completion of the proceedings under Rule 261, decides to revoke the suspension order.

Appellant brought suit in the District Court on June 13, 1961, contending that Rule 252(e)(2) is invalid because it deprives Holman of a substantial going business without notice or hearing. The complaint also charges that the Commission's proceedings are void because the order precipitating them was issued without a quorum and because of alleged ex parte communications by the Commission staff

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[3] In general, the charges against appellant are that the Pearson offering exceeded the $300,000 statutory maximum because a substantial block of the stock was purchased by a director of appellant (and his family) for his own account, sold back to Holman at higher prices, and thereafter resold to the public by Holman at various prices in excess of the initial offering price. The Commission also claims that material used in connection with several offerings contained untrue statements.

to members of the Commission. Appellant's requests for an injunction against continuation of Commission proceedings, and for a declaratory judgment holding Rule 252(e)(2) invalid, were denied by the District Court. Appellant's motions for a preliminary injunction and a stay of the Commission's proceedings were also denied.[4]

The threshold question is whether the District Court had jurisdiction to grant the relief requested. We believe it did as to the Rule 252(e)(2) issue, for reasons to be given presently. But we think that it lacked jurisdiction on the question of the procedural irregularities in the Commission proceedings alleged by appellant. Section 25 of the Securities Exchange Act of 1934, 15 U.S.C. § 78y, and Section 9 of the Securities Act of 1933, 15 U.S.C. § 77i, both provide for direct review in the Courts of Appeals of Commission orders. Appellant has permitted the sixty-day period, within which it might have sought review in a Court of Appeals, to expire. That statutory route certainly is applicable where mere procedural errors of the kind asserted by Holman are involved. Cf. *American Sumatra Tobacco Corp. v. Securities and Exchange Commission*, 68 App.D.C. 77, 93 F.2d 236 (1937); *Securities and Exchange Commission v. Andrews*, 88 F.2d 441 (2d Cir. 1937). The allegations made here—as to lack of a quorum and as to ex parte communications—even if true, are not necessarily of a fundamental nature, and the evidence developed in the hearing may prove to be such that, in the context of the whole case, the procedural irregularities will not amount to reversible error. Cf. *UNA Chapter; Flight Engineers' International Ass'n v. National Mediation Board*, U.S.App.D.C. , 294 F.2d 905 (1961). Allowing the Commission a prior opportunity to decide these matters avoids agency delay and gives the Commission a chance to correct its own errors. It may also, of course, eliminate any need for court review if the Commission eventually decides in Holman's favor.

On the other hand, Holman's challenge in the District

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[4] This court denied a stay of the Commission's administrative proceedings, pending review, as well as a stay of the effectiveness of Rule 252(e)(2).

Court to Rule 252(e)(2) would not seem to be precluded by the statutory provision for review by a Court of Appeals. Holman does not, in this suit, contest the validity of the temporary suspension of the Pearson issue, as such. Appellant's real attack is not against the suspension "order," which if final might have been subject to direct appellate review,[5] but against the consequence resulting from the operation of a separate rule, which followed from the temporary suspension. It therefore seems highly unlikely that Holman would have been permitted to obtain review of the temporary suspension order immediately and directly in this court.[6] But if Rule 252(e)(2) is invalid, Holman's business will have been extensively and perhaps irremediably damaged long prior to review of a final order.

We do not read the statutes which provide for direct review by this court as being exclusive where an order in itself is not being challenged, and where relief from its allegedly unconstitutional consequences might come too late. On the contrary, this would seem to be precisely the kind of situation where a direct test of the rule in a declaratory judgment proceeding would seem appropriate. Such a procedure is not only expeditious, but seems clearly within the intention and terms of both the Declaratory Judgments Act, 28 U.S.C. § 2201, and Section 10(b) of the Administrative Procedure Act, 5 U.S.C. § 1009(b). See *B. F. Goodrich Co. v. Federal Trade Commission*, 93 U.S.App.D.C. 50, 208 F.2d 829 (1953); *Parker v. Lester*, 227 F.2d 708 (9th Cir. 1955).

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[5] It has been held that only a "final order" is reviewable by a Court of Appeals under Section 9(a) of the Securities Act or Section 25(a) of the Securities and Exchange Act. See, *e. g.*, Jones v. Securities and Exchange Commission, 79 F.2d 617 (2d Cir.), affirming Securities and Exchange Commission v. Jones, 12 F. Supp. 210 (S.D. N.Y. 1935), *rev'd on other grounds*, 298 U.S. 1 (1936); Stardust, Inc. v. Securities and Exchange Commission, 225 F.2d 255 (9th Cir. 1955) (order for investigation); Securities and Exchange Commission v. Andrews, *supra*; Resources Corporation International v. Securities and Exchange Commission, 97 F.2d 788 (7th Cir. 1938); Guaranty Underwriters, Inc. v. Securities and Exchange Commission, 131 F.2d 370 (5th Cir. 1942).

[6] There is also some doubt as to whether, on petition to this court to review the order against it, Holman could test the validity of all the consequences of that order, including the restrictions imposed by Rule 252 (e)(2).

Appellee argues that appellant has not exhausted its administrative remedy under Rule 252(f), which provides that "upon a showing of good cause that it is not necessary under the circumstances that the exemption be denied," the disqualifying provisions of Rule 252(e)(2) shall not apply. We agree with Holman that the remedy provided by Rule 252(f) is inadequate to give it full relief. In effect that Rule gives the Commission discretion to remove the Rule 252(e)(2) disqualification with respect to a particular issue. Resort to it is accordingly not a mandatory prerequisite to this suit, which seeks relief of much broader nature.

We think that the District Court had, and we now have, jurisdiction to consider and decide the question whether Rule 252(e)(2) is invalid because it deprives Holman of a going business without notice or hearing.[7] We now turn to that question.

Holman appears to be making two assumptions about the question. The first assumption is that a hearing is required prior to the taking of agency action of the present sort. The second is that the mere bringing of charges

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[7] In response to Holman's motion in the District Court for declaratory and injunctive relief, Commission counsel moved to dismiss both because of lack of jurisdiction and forfeiture to state a cause of action. The order of Judge Tamm reads:

"The cause having come on for hearing on plaintiff's motion for preliminary injunction and defendants' motion to dismiss the complaint *for failure to state a cause of action* and the Court having heard the argument . . . it is hereby ORDERED . . . ." (Emphasis added.)

We read the order of the District Court as saying that the court assumed that it had jurisdiction, and then ruling on the motion to dismiss for failure to state a claim. Under Fed. R. Civ.P. 41(b), such a dismissal for failure to state a claim acts as an adjudication on the merits. We therefore need not remand, but, having concluded that the District Court had jurisdiction, are now free to review the Rule 252(e)(2) question on the merits. Moreover, there would be little practical reason for remanding to the District Court. A question of law is involved, and constitutional law at that. There would seem to be no new facts to be developed by the trial court which would help us in our determination. Neither party asks for remand, or suggests the need for fact-finding on the constitutional issue. Finally, we already have the case before us, have already had the benefit of argument, and can expedite proceedings by deciding the question now.

cannot lawfully result in any serious consequence to the person charged. Neither of these closely-related assumptions is tenable in the present context. In a wide variety of situations, it has long been recognized that where harm to the public is threatened, and the private interest infringed is reasonably deemed to be of less importance, an official body can take summary action pending a later hearing. Thus, in *Fahey* v. *Mallonee*, 332 U.S. 245 (1947), the action of the Federal Home Loan Bank Administration in appointing a conservator of a Savings and Loan Association prior to notice or hearing was upheld against constitutional challenge. And the summary seizure and destruction of food reasonably suspected of being unfit was many years ago sustained by the Supreme Court in *North American Cold Storage Co.* v. *Chicago*, 211 U.S. 306 (1908).[8]

A decision which is especially relevant to the case before us is *Halsey, Stuart & Co.* v. *Public Service Commission*, 212 Wis. 184, 248 N.W. 458 (1933). There, a statute providing for summary suspension of a stock broker's license, followed by a hearing if demanded by the broker, was upheld against a charge of unconstitutionality. To quote the opinion:

> "It is said that there is no provision for a hearing. It is true that there is none prior to suspension. We do not regard this as fatal to the validity of the law. Having in mind that this is an exercise of the police

[8] See also Adams v. Milwaukee, 228 U.S. 572 (1913). Thus, the seizure of articles in advance of a judicial determination of the seizure's legality has been sustained in many contexts. See, *e.g.*, People v. Diamond, 233 N.Y. 130, 135 N.E. 200 (1922) (wine); Haney v. Compton, 36 N.J.L. 507 (Ct. Err. & App. 1873) (seizure of fishing vessel). *Cf.* Bourjois, Inc. v. Chapman, 301 U.S. 183 (1937). Compare La Bonte v. City of Berlin, 85 N.H. 89, 154 Atl. 89 (1931), where the temporary suspension of a police officer was held permissible during investigation of charges.

Appellant relies on Greene v. McElroy, 360 U.S. 474 (1959), which dealt with the problem of permanently barring an individual from a type of employment for security reasons without a full hearing at any stage. But the question before us is not whether Holman is entitled to a hearing at all, but whether the hearing must be given *prior* to a temporary disqualification from making Regulation A offerings.

> power, and that it is valid in so far as it is reasonably necessary and appropriate to the promotion of the public welfare, it seems to us that the act must be sustained. The court may take notice of the fact that much harm may come to the citizens of the state, and that they may be the victims of much fraud and imposition unless they are speedily protected from improper practices in the sale of securities. Having in mind modern sales methods and the speed at which the business of today is done, promptness of action on the part of the commission may be the measure of its effectiveness. While the suspension may seriously damage the business of a particular broker, this consideration is not fatal to the validity of the act, provided it is reasonably necessary to protect the public. The rights of the public to exercise the police power in its own protection are superior to those of any individual broker to sell under his license or certificate." 248 N.W. at 461.

Cases of this sort involve a balancing of competing interests. The interest asserted by the Securities and Exchange Commission is protection of the securities-purchasing public. Normally, this is achieved by extensive registration and disclosure provisions. The Commission in Rule 252(c)(2) has provided that while a suspension hearing is in progress under Rule 261 these "usual" protective measures, rather than the far less protective requirements applicable under Regulation A, shall govern issuance of securities by a party against whom suspension proceedings have been instituted.

On the other hand, Holman is asserting an interest in continuing to issue public offerings of securities of $300,000 or less without full registration, despite the suspension proceeding pending against it. Appellant has not been completely put out of business, as it would be if its license were suspended. It can issue any security if it complies with full registration requirements. And appellant may even be free to undertake some or many Regulation A issues by resort to Rule 252(f), if it can make a sufficient

showing of good cause. Of course, Holman has been deprived of a portion of its previous business by the operation of Rule 252(c)(2). But this is a consequence very different from being put out of business entirely. In sum, the Securities and Exchange Commission's interest in protecting the public would seem to outweigh appellant's interest in being able to market small issues of securities without full registration for a temporary period while a hearing is in process.[9]

In all the statutes under which the Securities and Exchange Commission operates, Congress has given it broad rule-making powers. See III Loss, Securities Regulation 1936 *et seq.* (1961). In view of the nature of the subject matter, the grant of such powers was imperative, to protect investors against fraud or deception made possible by constantly changing conditions. In the field of exemptions from registration, the desire of Congress to protect the public appears paramount; the Commission is warned that in no event can it use the powers confided to it by Section 3(b) of the 1933 Act to exempt the public offering of an issue aggregating more than $300,000.[10] The House

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[9] Standard Airlines, Inc. v. Civil Aeronautics Board, 85 U.S. App. D.C. 29, 32, 177 F.2d 18, 21 (1949), and similar cases, involved different competing interests and are distinguishable. In Standard Airlines, for example, the public safety would have apparently not been seriously jeopardized by allowing Standard to remain in business until after hearings, since safety regulations were not involved. And the injury to the appellant in the Standard case caused by the temporary suspension seems to have been far more serious than the injury to Holman's business. See also Capital Airways, Inc. v. Civil Aeronautics Board, —— U.S. App. D.C. ——, 292 F.2d 755 (1961).

[10] Section 3(b) provides:

> "The Commission may from time to time by its rules and regulations, and subject to such terms and conditions as may be prescribed therein add any class of securities to the securities exempted as provided in this section, if it finds that the enforcement of this title with respect to such securities is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering; but no issue of securities shall be exempted under this subsection where the aggregate amount at which such issue is offered to the public exceeds $300,000."

Report on a bill offered in 1954 to amend certain provisions of the securities legislation noted that Regulation A in its present form "provides for disclosure and disciplinary checks and suspension powers to assure that issues offered under the regulation are offered under conditions which furnish practical protection against fraud."[11] The corresponding Senate Report also indicated that the Commission's regulations were known to the Congress and formed parts of the basis upon which the new proposals should be considered.[12] We must conclude that Congress saw nothing in Regulation A as a whole, or in Rule 252 in particular, which conflicted with its purposes; the contrary inference is rather to be drawn.

We conclude by saying that we find no arbitrariness in the operation of the challenged Rule in this case. The restriction imposed is a reasonable consequence of the charges reported against appellant by the Commission's staff, and is reasonably designed to protect the public until those charges are heard and adjudicated.

For these reasons, the judgment of the District Court will be

Affirmed.

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[11] H.R. Rep. No. 1542, 83d Cong., 2d Sess. 17 (1954).

[12] See S. Rep. No. 1036, 83rd Cong., 2d Sess. 8, 13 (1954).

of law; nor shall private property be taken for public use, without just compensation."

SECURITIES ACT OF 1933, SECTION 3(b)

SEC. 3. (b) The Commission may from time to time by its rules and regulations, and subject to such terms and conditions as may be prescribed therein, add any class of securities to the securities exempted as provided in this section, if it finds that the enforcement of this subchapter with respect to such securities is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering; but no issue of securities shall be exempted under this subsection where the aggregate amount at which such issue is offered to the public exceeds $300,000.

SECURITIES ACT OF 1933, SECTION 8(b) AND 8(d)

(b) If it appears to the Commission that a registration statement is on its face incomplete or inaccurate in any material respect, the Commission may, after notice by personal service or the sending of confirmed telegraphic notice not later than ten days after the filing of the registration statement, and opportunity for hearing (at a time fixed by the Commission) within ten days after such notice by personal service or the sending of such telegraphic notice, issue an order prior to the effective date of registration refusing to permit such statement to become effective until it has been amended in accordance with such order. When such statement has been amended in accordance with such order the Commission shall so declare and the registration shall become effective at the time provided in subsection (a) of this section or upon the date of such declaration, whichever date is the later.

. . . . . .

(d) If it appears to the Commission at any time that the registration statement includes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the state-

ments therein not misleading, the Commission may, after notice by personal service or the sending of registered telegraphic notice, and after opportunity for hearing at a time fixed by the Commission within [illegible] after such notice by personal service or the sending of such telegraphic notice, issue a stop order suspending the effectiveness of the registration statement, if any, and such statement has been amended in accordance with such stop order the Commission shall so declare and thereupon the stop order shall cease to be effective.

SECURITIES ACT OF 1933, SECTION 20(b)

(b) Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this subchapter, or of any rule or regulation prescribed under authority thereof, it may in its discretion, bring an action in any district court of the United States, or United States court of any Territory, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General who may, in his discretion, institute the necessary criminal proceedings under this subchapter. Any such criminal proceeding may be brought either in the district wherein the transmittal of the prospectus or security complained of is made, or in the district wherein such prospectus or security is received.

SECURITIES EXCHANGE ACT OF 1934, SECTION 15(b)

SEC. 15. (b) A broker or dealer may be registered for the purposes of this section by filing with the Commission an application for registration, which shall contain such information in such detail as to such broker or dealer and

any person directly or indirectly controlling or controlled by, or under direct or indirect common control with, such broker or dealer, as the Commission may by rules and regulations require as necessary or appropriate in the public interest or for the protection of investors. Except as hereinafter provided, such registration shall become effective thirty days after the receipt of such application by the Commission or within such shorter period of time as the Commission may determine.

An application for registration of a broker or dealer to be formed or organized may be made by a broker or dealer, to which the broker or dealer to be formed or organized is to be the successor. Such application shall contain such information in such detail as to the applicant and as to the successor and any person directly or indirectly controlling or controlled by, or under direct or indirect common control with, the applicant or the successor, as the Commission may by rules and regulations require as necessary or appropriate in the public interest or for the protection of investors. Except as hereinafter provided, such registration shall become effective thirty days after the receipt of such application by the Commission or within such shorter period of time as the Commission may determine. Such registration shall terminate on the forty-fifth day after the effective date thereof, unless prior thereto the successor shall, in accordance with such rules and regulations as the Commission may prescribe, adopt such application as its own.

If any amendment to any application for registration pursuant to this subsection is filed prior to the effective date thereof, such amendment shall be deemed to have been filed simultaneously with and as part of such application; except that the Commission may, if it appears necessary or appropriate in the public interest or for the protection of investors, defer the effective date of any such registration as thus amended until the thirtieth day after the filing of such amendment.

The Commission shall, after appropriate notice and opportunity for hearing, by order deny registration to or revoke the registration of any broker or dealer if it finds

that such denial or revocation is in the public interest and that (1) such broker or dealer whether prior or subsequent to becoming such, or (2) any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), or any person directly or indirectly controlling or controlled by such broker or dealer, whether prior or subsequent to becoming such, (A) has willfully made or caused to be made in any application for registration pursuant to this subsection or in any document supplemental thereto or in any proceeding before the Commission with respect to registration pursuant to this subsection any statement which was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact; or (B) has been convicted within ten years preceding the filing of any such application or at any time thereafter of any felony or misdemeanor involving the purchase or sale of any security or arising out of the conduct of the business of a broker or dealer; or (C) is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security; or (D) has willfully violated any provision of the Securities Act of 1933, or of this chapter, this title, or of any rule or regulation thereunder. Pending final determination whether any such registration shall be denied, the Commission may by order postpone the effective date of such registration for a period not to exceed fifteen days, but if, after appropriate notice and opportunity for hearing, it shall appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors to postpone the effective date of such registration until final determination, the Commission shall so order. Pending final determination whether any such registration shall be revoked, the Commission shall by order suspend such registration if, after appropriate notice and opportunity for hearing, such suspension shall appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors. Any regis-

tered broker or dealer may, upon such terms and conditions as the Commission may deem necessary in the public interest or for the protection of investors, withdraw from registration by filing a written notice of withdrawal with the Commission. If the Commission finds that any registered broker or dealer, or any broker or dealer for whom an application for registration is pending, is no longer in existence or has ceased to do business as a broker or dealer, the Commission shall by order cancel the registration or application of such broker or dealer.

SECURITIES EXCHANGE ACT OF 1934, SECTIONS 21 (e) AND (f)

SEC. 21. (e) Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this chapter, or of any rule or regulation thereunder, it may in its discretion bring an action in the proper district court of the United States or the United States courts of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be availabel concerning such acts or practices to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this chapter.

(f) Upon application of the Commission the district courts of the United States, and the United States courts of any Territory or other place subject to the jurisdiction of the United States, shall also have jurisdiction to issue writs of mandamus commanding any person to comply with the provisions of this chapter or any other of the Commission made in pursuance thereof or with any undertaking contained in a registration statement as provided in subsection (d) of section 780 of this title.

Rule 252. Securities Exempted.

(a) Except as hereinafter provided in this regulation, securities issued by any of the following persons shall be exempt from registration under the Act if offered in accordance with the terms and conditions of this regulation:

(1) Any corporation, unincorporated association or trust (i) which is incorporated or organized under the laws of the United States or Canada or any State or Province thereof and (ii) which has or proposes to have its principal business operations in the United States or Canada; or

(2) Any individual who is a resident of, and who has or proposes to have his principal business operations in, any State or Province; or

(3) In the case of an offering to existing security holders on a pro rata basis pursuant to warrants or rights, any direct or indirect majority-owned subsidiary of any issuer specified in (1) above which has securities registered on a national securities exchange pursuant to the provisions of the Securities Exchange Act of 1934.

(b) No exemption under this regulation shall be available for any of the following securities:

(1) Fractional undivided interests in oil or gas rights as defined in Rule 300, or similar interests in other mineral rights;

(2) Securities of any investment company registered or required to be registered under the Investment Company Act of 1940.

(c) *No exemption* under this regulation shall be available for the securities of any issuer if such issuer, any of its predecessors or any affiliated issuer—

(1) has filed a registration statement which is the subject of any proceeding or examination under Sec-

tion 8 of the Act, or is the subject of any refusal order or stop order entered thereunder within five years prior to the filing of the notification required by Rule 255;

(2) is subject to pending proceedings under Rule 261 or any similar rule adopted under Section 3(b) of the Act, or to an order entered thereunder within five years prior to the filing of such notification;

(3) has been convicted within five years prior to the filing of such notification of any crime or offense involving the purchase or sale of securities;

(4) is subject to any order, judgment or decree of any court of competent jurisdiction, entered within five years prior to the filing of such notification, temporarily or permanently restraining or enjoining such person from engaging in or continuing any conduct or practice in connection with the purchase or sale of securities; or

(5) is subject to a United States Post Office fraud order.

(d) No exemption under this regulation shall be available for the securities of any issuer, if any of its directors, officers, or principal security holders, any of its promoters presently connected with it in any capacity, any underwriter of the securities to be offered, or any partner, director or officer of any such underwriter—

(1) has been convicted within ten years prior to the filing of the notification required by Rule 255 of any crime or offense involving the purchase or sale of any security or arising out of such person's conduct as an underwriter, broker, dealer or investment adviser;

(2) is subject to any order, judgment or decree of any court of competent jurisdiction temporarily or permanently enjoining or restraining such person from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security or arising out of such person's conduct as an underwriter, broker, dealer or investment adviser;

(3) is subject to an order of the Commission entered

pursuant to Section 15(b) of the Securities Exchange Act of 1934; has been found by the Commission to be a cause of any such order which is still in effect; or is subject to an order of the Commission entered pursuant to Section 203(d) or (e) of the Investment Company Act of 1940;

(4) has been and is suspended or expelled from membership in a national or provincial security dealers association or a national securities exchange or a Canadian securities exchange for conduct inconsistent with just and equitable principles of trade; or

(5) is subject to a United States Post Office fraud order.

(c) No exemption under this regulation shall be available for the securities of any issuer if any underwriter of such securities, or any director, officer or partner of any such underwriter was, or was named as, an underwriter of any securities—

(1) covered by any registration statement which is the subject of any proceeding or examination under Section 8 of the Act, or is the subject of any refusal order or stop order entered thereunder, within five years prior to the filing of the notification required by Rule 255; or

(2) covered by any filing which is subject to pending proceedings under Rule 261 or any similar rule adopted under Section 3(b) of the Act, or to an order entered thereunder within five years prior to the filing of such notification.

(f) Paragraph (c), (d) or (e) shall not apply to the securities of any issuer if the Commission determines, upon a showing of good cause, that it is not necessary under the circumstances that the exemption be denied. Any such determination by the Commission shall be without prejudice to any other action by the Commission in any other proceeding or matter with respect to the issuer or any other person.

Rule 261. Suspension of Exemption.

(a) The Commission may, at any time after the filing of a notification, enter an order temporarily suspending the exemption, if it has reason to believe that—

(1) no exemption is available under this regulation for the securities purported to be offered hereunder or any of the terms or conditions of this regulation have not been complied with, including failure to file any report as required by Rule 260;

(2) the notification, the offering circular or any other sales literature contains any untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading;

(3) the offering is being made or would be made in violation of Section 17 of the Act;

(4) any event has occurred after the filing of the notification which would have rendered the exemption hereunder unavailable if it had occurred prior to such filing;

(5) any person specified in paragraph (c) of Rule 252 has been indicted for any crime or offense of the character specified in subparagraph (3) thereof, or any proceeding has been initiated for the purpose of enjoining any such person from engaging in or continuing any conduct or practice of the character specified in subparagraph (4) of such paragraph;

(6) any person specified in paragraph (d) of Rule 252 has been indicted for any crime or offense of the character specified in subparagraph (1) thereof, or any proceeding has been initiated for the purpose of enjoining any such person from engaging in or continuing any conduct or practice of the character specified in subparagraph (2) of such paragraph; or

(7) the issuer or any promoter, officer, director or

underwriter has failed to cooperate, or has obstructed or refused to permit the making of an investigation by the Commission in connection with any offering made or proposed to be made hereunder.

(b) Upon the entry of an order under paragraph (a) of this rule, the Commission will promptly give notice to the persons on whose behalf the notification was filed (i) that such order has been entered, together with a brief statement of the reasons for the entry of the order, and (ii) that the Commission, upon receipt of a written request within 30 days after the entry of such order, will, within 20 days after the receipt of such request, set the matter down for hearing at a place to be designated by the Commission. If no hearing is requested and none is ordered by the Commission, the order shall become permanent on the thirtieth day after its entry and shall remain in effect unless or until it is modified or vacated by the Commission. Where a hearing is requested or is ordered by the Commission, the Commission will, after notice of and opportunity for such hearing, either vacate the order or enter an order permanently suspending the exemption.

(c) The Commission may at any time after notice of and opportunity for hearing enter an order permanently suspending the exemption for any reason upon which it could have entered a temporary suspension order under paragraph (a) of this rule. Any such order shall remain in effect until vacated by the Commission.

(d) All notices required by this rule shall be given to the person or persons on whose behalf the notification was filed by personal service, registered mail or confirmed telegraphic notice at the addresses of such persons given in the notification.

D. Pearson "Temporary Suspension Order" of September 16, 1960.

In the Matter of Pearson Corporation

[File No. 24B-1077]

Securities Act of 1933, Section 3(b) and Regulation A

Order Temporarily Suspending Exemption, Statement of Reasons Therefor, and Notice of Opportunity for Hearing

I

Pearson Corporation, a Rhode Island corporation with its principal office at 1 Constitution Street, Bristol, Rhode Island, filed with the Commission on March 30, 1959, a notification on Form 1–A and an offering circular relating to an offering of 175,000 shares of its common stock, $.25 par value, purportedly at $1.00 per share, for the purpose of obtaining an exemption from the registration requirements of the Securities Act of 1933, as amended, pursuant to the provisions of Section 3(b) thereof and Regulation A promulgated thereunder.

II

The Commission has reasonable cause to believe that:

A. No exemption was available under Regulation A for the securities purported to be offered thereunder, that the terms and conditions of the regulation have not been complied with, and that the offering circular and other material used in connection with the offering contained untrue statements of material facts and omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, particularly with respect to the following:

1. The statement in the offering circular that the public offering price was $1.00 per share, in that there was a failure to disclose the method of offering whereby the stock was offered to the public at higher and undetermined prices

by the principal underwriter and by persons purchasing from the principal underwriter with a view to distribution and who in fact did so distribute the stock, and the failure to disclose the profit of such persons.

2. The offering of securities, purportedly under said notification and Regulation, when the aggregate public offering price of said securities and the aggregate gross proceeds actually received from their sale to the public exceeded $300,000.

3. The dissemination of materially misleading information concerning the termination of the public offering.

B. The said offering did operate as a fraud and deceit upon the purchasers.

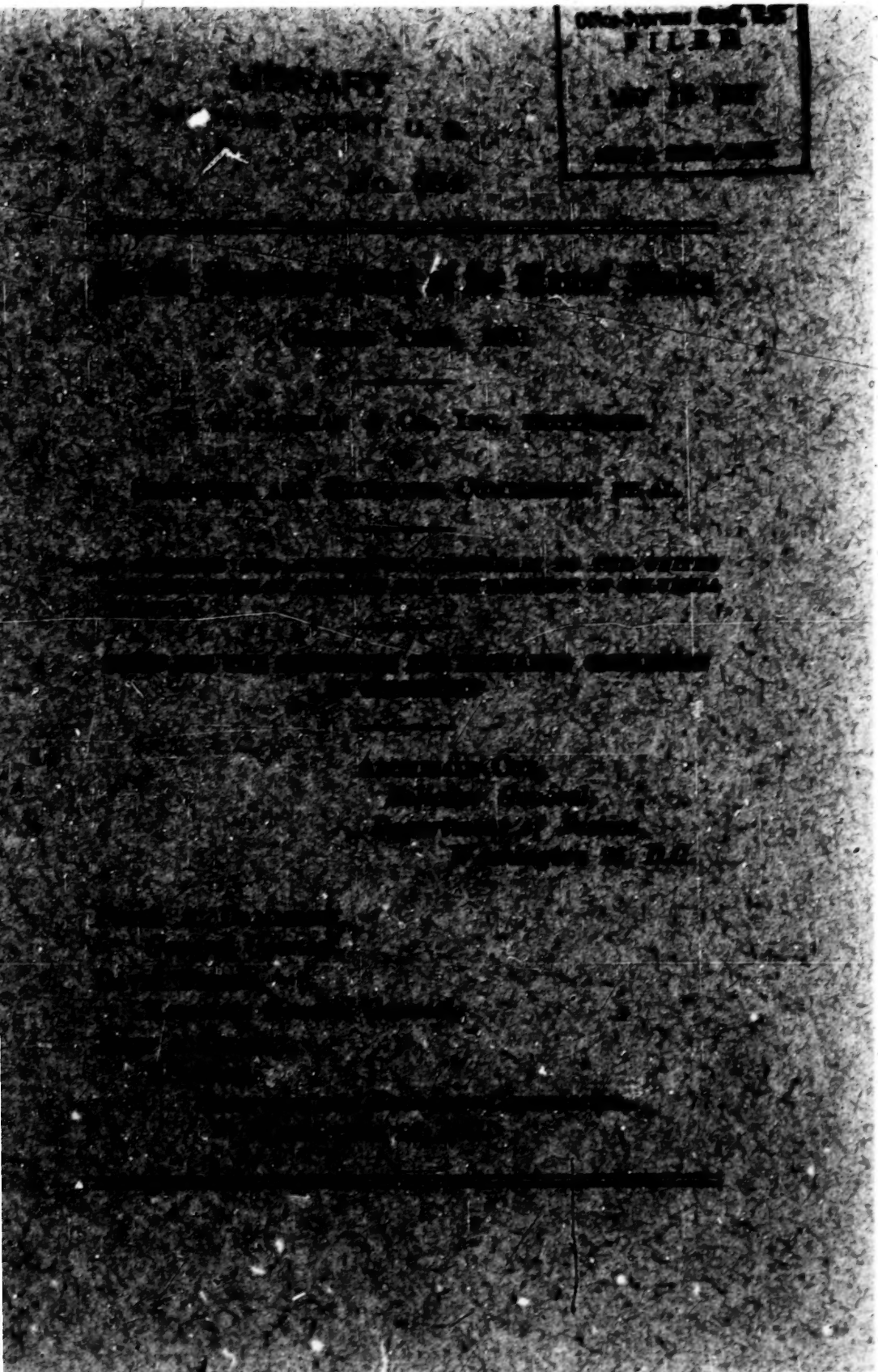
III

It is ordered, pursuant to Rule 261 of the General Rules and Regulations under the Securities Act of 1933, as amended, that the exemption under Regulation A be, and it hereby is, temporarily suspended.

Notice is Hereby Given to Pearson Corporation and to any persons having any interest in the matter that this order has been entered; that the Commission upon receipt of a written request within thirty days after entry of this order will, within twenty days after the receipt of such request, set the matter down for hearing at a place to be designated by the Commission for the purpose of determining whether to vacate the order or to enter an order permanently suspending the exemption without prejudice, however, to the consideration and presentation of additional matters at the hearing; that if no hearing is requested and none is ordered by the Commission, the order shall become permanent on the thirtieth day after its entry and shall remain in effect unless or until it is modified or vacated by the Commission; and that notice of the time and place for any hearing will promptly be given by the Commission.

By the Commission.

Orval L. DuBois,
Secretary.



INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statutes involved	2
Statement	2
Argument	6
Conclusion	13
Appendix	14

CITATIONS

Cases:

Civil Aeronautics Board v. *Delta Air Lines*, 367 U.S. 316 — 10

Ewing v. *Mytinger & Casselberry*, 339 U.S. 594 — 11

Greene v. *McElroy*, 360 U.S. 474 — 10

McGarry v. *Securities and Exchange Commission*, 147 F. 2d 389 — 12

Myers v. *Bethlehem Shipbuilding Corporation*, 303 U.S. 41 — 12

Ross v. *Stewart*, 227 U.S. 530 — 12

Securities and Exchange Commission v. *Otis & Company*, 338 U.S. 843, reversing 176 F. 2d 34 — 12

T.S.C. Motor Freight Lines, Inc. v. *United States*, 186 F. Supp. 777, affirmed *sub nom. Herrin Transportation Company* v. *United States*, 366 U.S. 419 — 13

640522—62——1

Cases—Continued

	Page
United States v. *Chemical Foundation*, 272 U.S. 1	12

Statutes and rules:

Securities Act of 1933, 48 Stat. 74, as amended, 15 U.S.C. 77a, *et seq.*:	
Section 3(b)	3, 6, 8, 10
Section 9(a)	11, 14
Section 11	7, 15
Securities Exchange Act of 1934, 48 Stat. 881, as amended, 15 U.S.C. 78a, *et seq.*:	
Section 15(b)	2, 4
Section 15A	2
Section 25(a)	11, 16
Regulation A of the Securities and Exchange Commission, 17 C.F.R. 230.251, *et seq.*:	
Rule 252(e)(2)	5, 6, 8, 9
Rule 252(f)	5
Rule 261	3, 4, 5, 11

Miscellaneous:

Foster, *Application of the Administrative Procedure Act to the Statutes Administered by the Securities and Exchange Commission*, N.Y.U. School of Law Institute Proceedings, Vol. VII (1947)	9
Hearings before the Subcommittee of the House Committee on Interstate and Foreign Commerce, Securities Act Amendments, 1959, 86th Cong., 1st Sess.	8
Hearings before the Subcommittee of the Senate Committee on Banking and Currency, 85th Cong., 1st Sess., S. 810 and S. 843	8

Miscellaneous—Continued
Hearings before the Subcommittee of the Senate Committee on Banking and Currency, 86th Cong., 1st Sess., S. 1178 and S. 1182 ..... Page 8
H. Rep. No. 1542, 83d Cong., 2d Sess 7
Securities and Exchange Commission, 22d Annual Report (1956) 8
Securities and Exchange Commission, 25th Annual Report (1959) 9
S. Rep. No. 438, 85th Cong., 1st Sess 8

In the Supreme Court of the United States

October Term, 1961

No. 884

R. A. HOLMAN & CO., INC., PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 28–37) is reported at 299 F. 2d 127. The order of the district court was entered without opinion and is set forth at J.A. 53.

JURISDICTION

The judgment of the court of appeals was entered on January 18, 1962. (Pet. App. 28). The petition for a writ of certiorari was filed on April 17, 1962. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether the Commission had the authority to promulgate a rule exempting small issues of securities from registration pursuant to Section 3(b) of the Securities Act except where an underwriter of the securities is subject to pending proceedings to determine charges of misuse of the exemption for an earlier issue of securities.

2. Whether petitioner's allegation that a Commission proceeding was instituted by an order issued without a proper quorum being present permits it to seek review of that order by a suit for injunction in the district court, despite Section 9(a) of the Securities Act of 1933, which provides for exclusive review of Commission orders in the courts of appeals.

STATUTES INVOLVED

Pertinent provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, and Regulation A, promulgated by the Commission under the Securities Act of 1933, are set forth at pages 38–47 of petitioner's appendix and in the appendix to this brief, *infra*, pp. 14–17.

STATEMENT

Petitioner is a broker and dealer in securities registered under Section 15(b) of the Securities Exchange Act of 1934 and is a member of the National Association of Securities Dealers, a national securities association registered under Section 15A of that Act. In September 1960 the Securities and Exchange Commis-

sion instituted two proceedings involving petitioner (J.A. 9; App. 1, 2, 7).[1]

Regulation A, promulgated by the Commission pursuant to Section 3(b) of the Securities Act of 1933, provides that under certain conditions an issue of securities not in excess of $300,000 may be exempted from the registration provisions of the Securities Act. In reliance on this regulation, petitioner underwrote an issue of 175,000 shares of common stock of Pearson Corporation, which it purportedly offered to the public for $1 a share (J.A. 33–34).[2] The first proceeding against petitioner was instituted on September 16, 1960, when the Commission issued an order under Rule 261 of Regulation A temporarily suspending the exemption for the Pearson issue. The Commission

[1] "J.A." refers to the Joint Appendix. "App." refers to the Appendix to the Commission's brief in the court below.

[2] Materials filed with the Commission in connection with the Regulation A offering had stated that the securities were being offered to the public at $1 per share and it was reported that the entire 175,000 shares had been purchased by the public within 4 days. In reviewing a subsequent registration statement of the Pearson Corporation, the staff of the Commission noted that the Pearson stock thereafter had advanced from the $1 offering price to a high of $13 per share. It was subsequently learned that a substantial block of this stock, which purportedly had been purchased by the "public," had in fact been purchased by Richard A. Holman, president and director of petitioner and by members of his immediate family for their own personal account at $1 per share; that these shares had subsequently been sold back to petitioner at varying prices up to $6.50 per share; and that they had thereafter been resold to the public by petitioner at various prices substantially in excess of the initial offering price of $1 per share (J.A. 34–35).

order stated that the Commission had reasonable cause to believe that the offering of the Pearson stock to the public had exceeded $300,000 and that the exemption was therefore not available, that the sales literature was misleading, and that the offering had operated as a fraud and deceit upon the purchasers. Under Rule 261, any one of these charges is a ground for suspension of the exemption.

The second proceeding against petitioner was instituted on September 26, 1960, to determine whether petitioner's registration as a securities broker and dealer under Section 15(b) of the Securities Exchange Act should be revoked and whether petitioner should be suspended or expelled from membership in the National Association for Securities Dealers (App. 2). Because common questions of law and fact were involved, this proceeding was consolidated on October 31, 1960, with the proceeding under Rule 261 (App. 7). Prior to the commencement of hearings the order instituting the revocation proceeding under Section 15(b) was amended to allege additional violations by petitioner (App. 8).[3]

During the pendency of the consolidated proceedings, petitioner has continued as a registered broker and dealer in securities and a member of the National Association of Securities Dealers. He may act

[3] The additional violations were also the subject of a subsequent proceeding under Section 15(b) of the Securities Exchange Act involving the denial of an application for registration by a former employee of petitioner. That proceeding was at a later date consolidated with the pending proceedings (J.A. 19-20).

as an underwriter of securities issues where a registrant statement is filed pursuant to the provisions of the Securities Act, and the Commission's files show that he has been named as underwriter in connection with such filings. See Commission File Nos. 2-17224 and 2-30223. By reason of Rule 252(e)(2) of Regulation A, however, petitioner cannot act as the underwriter of securities that are unregistered and offered pursuant to the Regulation A exemption until the proceeding instituted under Rule 261 is finally determined in its favor.[1] The record shows that the protracted nature of the consolidated proceedings before the Commission's hearing examiner has resulted in large part from numerous adjournments granted at petitioner's request (J.A. 37-39).

During one such adjournment, in June 1961, petitioner filed its complaint in the district court seeking an injunction against the Commission's proceedings and a declaratory judgment invalidating Rule 252(e)(2). That rule provides that Regulation A is not available to exempt an issue of securities from registration where the underwriter is the subject of pending proceedings under Rule 261 (J.A. 8). In addition to its assertion that this provision is invalid, petitioner also alleged that the Commission's order initiating the proceedings under Rule 261 was issued on the basis of an improper *ex parte* presentation by the staff

[1] If that proceeding is determined adversely to petitioner, the disqualification lasts for a five-year period thereafter. See Rule 252(e)(2). The Commission, however, pursuant to Rule 252(f), may lift the disqualification upon a showing of good cause at any time before or after the determination of the proceeding.

of the Commission and without the presence of a quorum of the Commission. The district court dismissed the complaint (J.A. 53), and the court of appeals unanimously affirmed.

ARGUMENT

The decision below was clearly correct and no question is presented warranting review by this Court.

1. Section 3(b) of the Securities Act makes clear that the Commission is to exercise wide discretion in conditioning exemptions from the registration requirements of the Act. That section authorizes the Commission by rule to grant exemptions from registration for offerings of securities not in excess of $300,000 "subject to such terms and conditions as may be prescribed" by the Commission, where it finds that compliance with the registration requirements is "not necessary in the public interest and for the protection of investors." We submit that Rule 252(c)(2)—which provides that the small-issues exemption is not available when the underwriter is charged with an earlier abuse of the exemption—is a valid exercise of this discretion.

The Commission's experience has led it to conclude that stringent conditions are essential to an exemption under Section 3(b) for the proper protection of the investing public since a filing under Regulation A is not, as petitioner implies, a "short form registration" (Pet. 4). Instead, it is an exemption from registration. Where securities are sold pursu-

[1] Petitioner is not now seeking to raise this issue in this Court.

ant to Regulation A, investors do not have the protection of the complete information contained in registration statements. Independently audited, certified financial statements are not required. The civil remedies against the issuing companies, underwriters, and others that are provided by Section 11 of the Act with respect to misstatements in registration statements are not available for non-registered offerings pursuant to Regulation A.

The importance of the protection attaching to the registration process is emphasized in a report of the House Committee on Interstate and Foreign Commerce relating to a proposed amendment of Section 3(b) of the Securities Act to increase the authorized ceiling of the Regulation A exemption from $300,000 to $500,000. The report stated (H. Rep., No. 1542, 83d Cong., 2d Sess., p. 18 (1954)):

> Regardless of the processing which the Commission may give to the offering circular filed with it under regulation A, or similar regulations pertaining to securities exempted from registration under this section, the remedies available to the investor are limited to those under section 12 of the act; namely, they apply only against the specific individual who may have sold him the security. The investor does not receive the protection of section 11 which, as described above in this report in the discussion of the amendment to section 5 of the 1933 act, provides that as to registered securities,

> he may have remedies against the issuer, its officers and directors, every underwriter, controlling persons, and every accountant, engineer or other expert involved. It is also significant that only in the case of registered securities is there a requirement for independently audited certified financial statements.

The amendment was not enacted."

Regulation A, however, provides an exemption from the protection provided by the registration process. But Rule 252(c)(2) limits the exemption to companies employing underwriters who have not been involved in distributions where abuse of the exemption

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[2] Petitioner points out (Pet. 19, note 9) that Rule 252(c)(2), the challenged provision of Regulation A, was adopted in 1956, and therefore claims that the court below erred in referring to 1954 Congressional reports upon which to base its conclusion that Congress saw nothing objectionable "in Regulation A as a whole, or in Rule 252 in particular." But that statement is supported by the fact that Congress has subsequently, in 1957 and 1959, failed to adopt a similar amendment to raise the ceiling on exemptions under Section 3(b) of the Act. See Hearings before the Subcommittee of the Senate Committee on Banking and Currency, 85th Cong., 1st Sess., S. 810 and S. 843 (1957), pp. 4–6, 9–15; Hearings before the Subcommittee of the Senate Committee on Banking and Currency, 86th Cong., 1st Sess., S. 1178–S. 1182 (1959), pp. 6–8, 116–118; Hearings before the Subcommittee of the House Committee on Interstate and Foreign Commerce, 86th Cong., 1st Sess., Securities Acts Amendments, 1959, pp. 143–144, 149–150. In 1957, the Senate report on such a bill pointed out in a discussion of the anti-fraud features of Regulation A that in 1956 the Commission had revised the regulation, *inter alia*, to make the exemption unavailable if the underwriter of the issuer "has been the underwriter of any other issue which is the subject of a pending * * * suspension order proceeding." S. Rep. No. 438, 85th Cong., 1st Sess., (1957), p. 8. And see also the Commission's 22d Annual Report to Congress (1956), p. 29.

has been found or is currently charged. Because of the civil liabilities of Section 11 of the Securities Act, there has been a cooperative attitude on the part of registrants and underwriters concerning issues of securities to which the exemption does not apply, since "the possibility of putting something over on the Commission and getting by with a less than adequate registration statement is obviously not worth running the risk of being liable for rescission or damages." See, Foster, *Application of the Administrative Procedure Act to the Statutes Administered by the Securities and Exchange Commission*, N.Y.U. School of Law Institute Proceedings, vol. VII (1947), p. 226. The Commission has found, on the other hand, that exemption of securities from registration and civil liability may open a way for evasion by those bent on fraud. See 25th Annual Report of the Securities and Exchange Commission (1959), pp. 4–5. Hence, it was not unreasonable for the Commission to condition the availability of the small-issues exemption upon the employment of presumably responsible underwriters. This is particularly so since the Commission has found that Rule 252(c)(2) does not impede financing by small companies because such companies can normally use other underwriters.

Petitioner contends (Pet. 18–21) that Rule 252(c)(2) is contrary to the pattern of the federal securities acts of providing notice and opportunity for hearing as prerequisites to imposition of a sanction against a broker and dealer in securities. This contention, however, ignores the distinction between complete exclusion from the securities industry, which is the statu-

tory sanction, and a limitation on the privilege of participating in exempt distributions of securities, which is the effect of Rule 252(e)(2). More important, Section 3(b) of the Securities Act gives the Commission authority to formulate the terms and conditions under which exempt offerings of small issues may be made—limited only by the requirement that the Commission must determine, before allowing an exemption, that the public interest and the protection of investors do not require registration. The Commission has reasonably found, on the basis of its experience, that the needs of the investing public require temporary disqualification of underwriters, charged with misuse of the exemption in a previous underwriting, from participating in another exempt issue.

Petitioner is not being denied due process of law on the charges made against it: it is a party to a full evidentiary hearing on all the charges made against it. Petitioner has the right to cross-examine witnesses, to submit briefs, to file exceptions to the recommended decisions of the hearing examiner, and to argue before the Commission. The Commission's determination will be made upon the evidentiary record and, should it ultimately decide to exclude petitioner from the securities industry or impose any lesser sanction, petitioner will have full opportunity to review that determination in a court of

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The cases relied upon by petitioner (Pet. 15), *Greene* v. *McElroy*, 360 U.S. 474, and *Civil Aeronautics Board* v. *Delta Air Lines*, 367 U.S. 316, are clearly distinguishable. Both cases involved a permanent disqualification, in the former upon the basis of a hearing without the right of confrontation and cross-examination, and in the latter without any hearing at all.

appeals. This Court has repeatedly pointed out "that no hearing at the preliminary stage is required by due process so long as the requisite hearing is held before the final administrative order becomes effective." *Ewing* v. *Mytinger & Casselberry*, 338 U.S. 594, 598, and cases cited therein.

2. Petitioner claims that there was no quorum of the Commission present when on September 16, 1960, the Commission instituted the proceeding under Rule 261 charging it with misusing the small-issues exemption in an earlier issue of stock. On this basis, it sought in the district court to enjoin the consolidated proceeding pending against it before the Commission. Both courts below refused the injunction.

We submit the courts below were correct for at least three reasons. First, Section 9(a) of the Securities Act and Section 25(a) of the Securities Exchange Act both provide that orders of the Commission are reviewable exclusively in the courts of appeals. Therefore, the district court had no jurisdiction to enjoin the Commission's proceeding whether or not petitioner's substantive contentions are correct. As the court below stated, the alleged irregularity in the institution of the proceeding may be reviewed only by a court of appeals on review of any final order that might be adverse to petitioner, when the order could be considered in the context of the entire evidentiary

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*If this Court grants the petition, the Commission reserves the right to urge, contrary to the decision of the court of appeals, that Section 9(a) of the Securities Act of 1933 provides that review of Commission orders is exclusively in the courts of appeals and that therefore petitioner could not challenge the action of the Commission by a suit for injunction or declaratory judgment in the district court.

record. This Court has repeatedly held, in similar situations, that judicial review should await exhaustion of the administrative process. See, *e.g.*, *Myers* v. *Bethlehem Shipbuilding Corporation*, 303 U.S. 41; *Securities and Exchange Commission* v. *Otis & Company*, 338 U.S. 843, reversing 176 F. 2d 34 (C.A. D.C.).

Second, subsequent to the order of September 16, 1960, the Commission entered various orders, as to which there is no question concerning the presence of a quorum, ratifying the earlier order. For example, on October 31, 1960, the Commission issued an order directing that a hearing be held on November 21, 1960, on whether the temporary suspension of Pearson's offering should be made permanent (App. 5). The recitation of issues was identical to the reasons set forth in the Commission's order of September 16, 1960, enumerating the reasons for temporarily suspending the Pearson offering. The Commission also entered an order on October 31, 1960, consolidating the proceeding involving the suspension of the Pearson Corporation's exemption from registration with the proceeding seeking the revocation of petitioner's broker-dealer registration, since they involved "several common questions of law and fact" (App. 7).

In any event, petitioner's allegations are insufficient to rebut the presumption of regularity attaching to the Commission's order.[9] The allegations are based on

[9] "The presumption of regularity supports the official acts of public officers and, in the absence of clear evidence to the contrary, courts presume that they have properly discharged their official duties." *United States* v. *Chemical Foundation*, 272 U.S. 1, 14–15. See also *Ross* v. *Stewart*, 227 U.S. 530, 535, and *McGarry* v. *Securities and Exchange Commission*, 147 F. 2d 389, 393 (C.A. 10).

the affidavit of petitioner's president that he "understood" the then chairman of the Commission to have stated that "only two of the five members of the Commission were present at the time the suspension order" was issued (J.A. 13). A quorum of an administrative agency may vote to authorize certain action without being physically assembled together in each other's presence. *T.S.C. Motor Freight Lines, Inc.* v. *United States*, 186 F. Supp. 777, 785 (S.D. Tex.), affirmed *sub nom. Herrin Transportation Company* v. *United States*, 366 U.S. 419. Accordingly, even if only two members of the Commission had been physically present, this fact alone would raise no question as to the existence of a valid vote.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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Securities and Exchange Commission.

MAY 1962.

APPENDIX

Securities Act of 1933, 48 Stat 74, as amended, 15 U.S.C. 77a, *et seq.*:

. . .

COURT REVIEW OF ORDERS

SEC. 9. (a) Any person aggrieved by an order of the Commission may obtain a review of such order in the Court of Appeals of the United States, within any circuit wherein such person resides or has his principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the entry of such order, a written petition praying that the order of the Commission be modified or be set aside in whole or in part. A copy of such petition shall be forthwith transmitted by the clerk of the court to the Commission, and thereupon the Commission shall file in the court the record upon which the order complained of was entered, as provided in section 2112 of title 28, United States Code. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission. The finding of the Commission as to the facts, if supported by evidence, shall be conclusive. If either party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the hearing before the Commission, the court may order such additional evidence to be taken before the

Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file such modified or new findings, which, if supported by evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The jurisdiction of the court shall be exclusive and its judgment and decree, affirming, modifying, or setting aside, in whole or in part, any order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 346 and 347).

* * * * *

CIVIL LIABILITIES ON ACCOUNT OF FALSE REGISTRATION STATEMENT

SEC. 11. (a) In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue—

(1) every person who signed the registration statement;

(2) every person who was a director of (or person performing similar functions) or partner in, the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;

(3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;

(4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him;

(5) every underwriter with respect to such security.

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Securities Exchange Act of 1934, 48 Stat. 881, as amended, 15 U.S.C. 78a, *et seq.*:

COURT REVIEW OF ORDERS.

SECTION 25. (a) Any person aggrieved by an order issued by the Commission in a proceeding under this title to which such person is a party may obtain a review of such order in the United States Court of Appeals within any circuit wherein such person resides or has his principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the entry of such order, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall be forthwith transmitted by the clerk of the court to any member of the Commission, and thereupon the Commission shall file in the court the record upon which the order complained of was entered, as provided in section 2112 of title 28, United States

Code. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record shall be exclusive, to affirm, modify, and enforce or set aside such order, in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If either party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the hearing before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts, by reason of the additional evidence so taken, and it shall file such modified or new findings, which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, and enforcing or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 346 and 347).

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